

# AIRA



## 36<sup>TH</sup> ANNUAL BANKRUPTCY & RESTRUCTURING CONFERENCE

# Third Party Releases

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# Introduction to Third Party Releases

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# What Are Third Party Releases?

- The Bankruptcy Code (the “Code”) provides a discharge of pre-confirmation debt for chapter 11 debtors. See Code Section 1141(d)(1)(A).
  - However that discharge is limited in a number of ways.
    - ❖ An individual debtor does not receive a discharge of debt which is excepted from discharge pursuant to Section 523 of the Code. Section 523 lists types of debt that by their nature are excluded from being discharged.

# What Are Third Party Releases? (Cont.)

- A debtor which is an entity other than an individual does not receive a discharge if the Chapter 11 plan provides for the liquidation of the debtor's assets and the debtor does not engage in business after consummation of the plan. See Code Section 1141(d)(3). That same section precludes an individual chapter 11 debtor from receiving a discharge pursuant to a liquidating plan where the debtor does not conduct post plan consummation business and if the debtor has engaged in the kind of disreputable activity that would bar a chapter 7 discharge. See Code Section 727(a).
- Therefore, even the right of a chapter 11 debtor to receive a discharge is broad, but not absolute.

# Why Are Third Party Releases Controversial?

- Code Section 524(e) says that “[a] discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.”
  - Therefore, the general rule is that a debtor’s debts may be discharged under many circumstances, but the liability of others who may be liable for that same debt are not discharged or released.
- There are no other provisions of the Code which specifically provide for the release of non-debtors pursuant to a Chapter 11 plan.

# Why Are Third Party Releases Controversial? (Cont.)

- However, most plans in large complex cases contain provisions that provide for the release of liability to third parties.
  - Typically the non-debtors receiving the benefit of such releases might include officers and directors of the debtor, the creditors committee members, the plan funder, the lenders and the professionals for all of the released parties.
  - The releases come in many forms. Sometimes they are in the form of an injunction, indemnity, hold harmless or covenant not to sue. Sometimes they come in the form of exculpation provisions. Sometimes they come in the form of actual releases. Often the plan contains more than one clause that accomplishes the same releases to the same parties. A plan may include releases from a debtor to third parties. Some plans purport to contain releases from creditors to certain third parties.

# Why Are Third Party Releases Controversial? (Cont.)

- There is little controversy that a debtor may provide releases to third parties. Code Section 1123(b)(3) provides that a plan may provide for the “settlement or adjustment of any claim or interest belonging to the debtor or the estate...” Therefore, if the debtor holds a claim against a third party, that claim may be released pursuant to the plan.

# Why Are Third Party Releases Controversial? (Cont.)

- If the releases and exculpation provisions provide for release of only post-petition activities the provisions tend to be less controversial. After all, many business transactions provide a resolution of disputes arising in the process of negotiating the deal itself. Some releases and exculpation provisions provide releases for activities that occurred pre-petition as well as during the case. These provisions are often the subject of objection even though claims held by the debtor against third parties can ordinarily be released. Such claims against non-debtor parties may however be a perceived source of recovery by creditors. In that case, proposed releases could be the subject of dispute. For example, a release of the debtor's officers and directors may be controversial if the creditors would prefer to seek recoveries from those parties.

# Can Creditors be Compelled to Release Claims Against Non-Debtor Third Parties?

- Many plans not only call for the release of claims held by the debtor against third parties, but go further and seek to provide releases by third parties against other third parties. For example, the plan may provide for the release and/or exculpation of any claim held individually by any creditor against the officers and directors of the debtor or against the debtor's lenders. Sometimes these clauses are limited to activities related to the chapter 11 case and the plan negotiations and implementation. Sometimes the scope of the release is far broader. For example the plan may purport to release parties who are liable for some of the debt of the debtor. For example, insurance companies or guarantors could fall into that category. Sometimes the breadth of the release provisions would be subject to interpretation that would even bar claims between third parties for which the debtor has no liability.

# Can Creditors be Compelled to Release Claims Against Non-Debtor Third Parties? (Cont.)

- What authority could exist to justify the compelling of one non-debtor to provide a release to another non-debtor?
- Can a creditor be required to release a third party if its class of creditor votes in favor of the plan?
- Does the creditor have to consent specifically?
- Does an acceptance of a plan constitute consent?
- Does an acceptance of a plan constitute consent if an opt-out section on the ballot is not filled in specifically objecting to the release?
- Does a rejection of the plan constitute consent if an opt-out section on the ballot is not filled in specifically objecting to the release?

# Do Courts Allow Third Party Releases?

- Certainly if the party granting the releases consents to such terms. Absent consent it is harder for a court to justify forcing a third party to release another third party.
- The circumstances make the release more or less likely to be approved by the court over the objection of the releasing non-debtor party.
  - If the release is of a claim of a creditor against a guarantor or surety of a debt owed by the debtor, the release is more likely to be rejected by the court since Code Section 524(e) would appear to be directly applicable.

# Do Courts Allow Third Party Releases? (Cont.)

- However, if the proposed third party release from a creditor or class of creditors runs to a party (even if a co-obligor) that (i) has settled a controversy and (ii) as part of the settlement is willing to fund a beneficial plan in return for a release? Courts are sometimes willing to approve such releases as part of a plan.
- If the release is to be granted as part of a mass tort Chapter 11 plan, the release is more likely to be allowed. For example, in many asbestos cases a “pot” to provide for payment of victims is funded by the proceeds of insurance. The insurance companies may be willing to fund the pot, but are not willing to do so unless they receive a release from individual claimants. Cases have allowed such plans. Congress specifically provided for such plans in Code Section 524(g) to allow for such plans in cases with mass asbestos liability. However many mass tort chapter 11 cases do not deal with asbestos making section 524(g) inapplicable. Even in asbestos cases the strict limitations of section 524(g) may limit the utility of that section.

# What Criteria Do Courts Consider?

- Circuit Courts of different judicial circuits require the consideration of different criteria in determining whether to allow non-debtor third party releases.
  - The Fifth, Ninth and Tenth Circuits generally hold that section 524(e) of the Code bars non-consensual third party releases. The other circuits which have dealt with this issue are more willing to allow non-consensual third party releases pursuant to Section 105(a) of the Code. That provision allows a bankruptcy court to issue any order that is necessary or appropriate to carry out the provisions of the Code.

# What Criteria Do Courts Consider? (Cont.)

- Most of the Circuits which allow non-debtor third party releases only do so if extraordinary or unusual circumstances exist. Such releases are not the norm and are not contemplated or provided for by the provisions of the bankruptcy code.
- All circuits which allow such non-debtor releases also require adherence to a particular standard of review. In the Eighth Circuit the standard of review requires a balancing of the factors established in [In re Master Mortg. Inv. Fund, Inc., 168 B.R. 930, \(Bankr. W.D. Mo. 1994\)](#). The Second, Third and Seventh Circuits allow third party releases when unusual circumstances exist and the standards set forth in [In re Metromedia Fiber Network, Inc., 416 F.3d 136, \(2d Cir. 2005\)](#) are met. In the Fourth, Sixth and Eleventh Circuits the factors to be balanced are set forth in [In re Dow Corning Corp., 280 F.3d 648 \(6th Cir. 2002\)](#).

# What Criteria Do Courts Consider? (Cont.)

- The Master Mortgage factors to be considered are:
  - ❖ Is there an identity of interest between the debtor and the third party receiving the release? This would usually be an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor which will deplete assets of the estate.
  - ❖ Has the non-debtor receiving the release contributed substantial assets to the reorganization?

# What Criteria Do Courts Consider? (Cont.)

- ❖ Is the release essential to the reorganization? Without the grant of the release, is there little likelihood of a successful reorganization?
- ❖ Do a substantial majority of the releasing creditors agree to such injunction? Has the class being required to grant the release "overwhelmingly" voted to accept the proposed plan treatment?
- ❖ Does the plan provide a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the release?
- ❖ The test requires a balancing of the factors.
- ❖ The factors are not an exclusive list of considerations nor is every factor required in each particular case.

# What Criteria Do Courts Consider? (Cont.)

- The Metromedia considerations are:
  - ❖ Is the plan a global settlement of massive liabilities against the debtors and co-liable parties?
  - ❖ Was there a substantial financial contribution by parties receiving the release in exchange for the release?
  - ❖ Did such substantial contributions make the reorganization feasible and was the contribution necessary to the plan and its success.

# What Criteria Do Courts Consider? (Cont.)

- ❖ Was consideration received by the creditors who are being required to provide releases (this consideration has weight in equity, but is not required).
- ❖ Were enjoined claims channeled to a settlement fund rather than extinguished?
- ❖ Would the released claims, if the release were denied, indirectly impact the reorganization by creating indemnity or contribution claims?
- ❖ Are the released claims paid in full under the plan?
- ❖ Did the releasing creditors consent to being enjoined?

# What Criteria Do Courts Consider? (Cont.)

- The Dow factors are:
  - ❖ Is there an identity of interests between the debtor and the third party receiving the release- usually in the form of an indemnity relationship? Would a suit against the non-debtor, in essence be a suit against the debtor because of such identity of interests? Will such suit deplete the assets of the estate?
  - ❖ Has the non-debtor party being released contributed substantial assets to the reorganization?

# What Criteria Do Courts Consider? (Cont.)

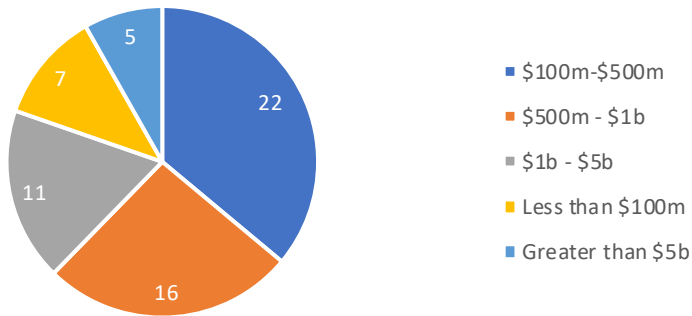
- ❖ Is the release is essential to reorganization? Does the reorganization hinge on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor?
- ❖ Have the impacted class, or classes, overwhelmingly voted to accept the plan?
- ❖ Does the plan provide a mechanism to pay for all, or substantially all, of the claims affected by the release?
- ❖ Does the plan provide an opportunity for those claimants who choose not to settle to recover in full?
- ❖ Has the bankruptcy court made a record of specific factual findings that support its conclusions?

# Business Considerations

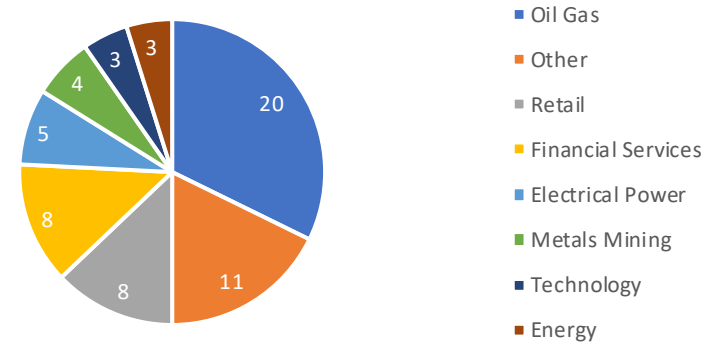
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# Contested Third Party Releases (# of Filings in Last Five Years)

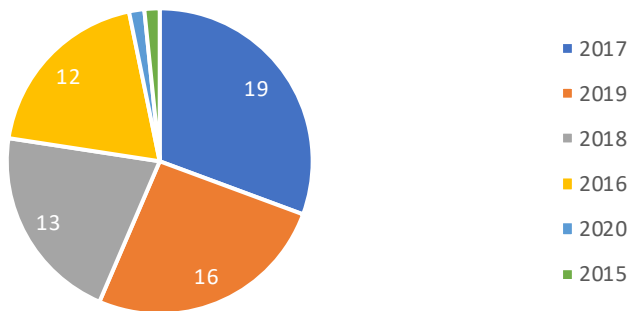
By Liability Size



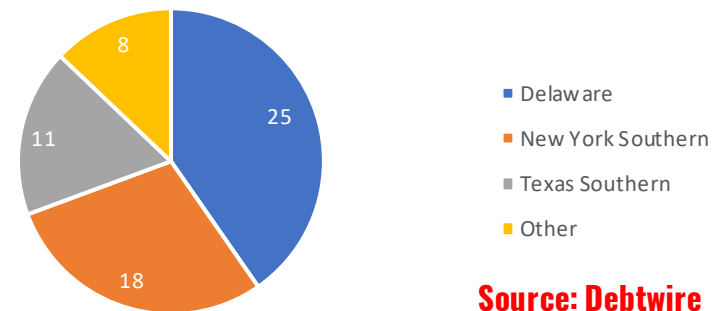
By Industry



By Case Commencement Year



By Venue



Source: Debtwire

# Factors Driving The Business Need for Third Party Releases

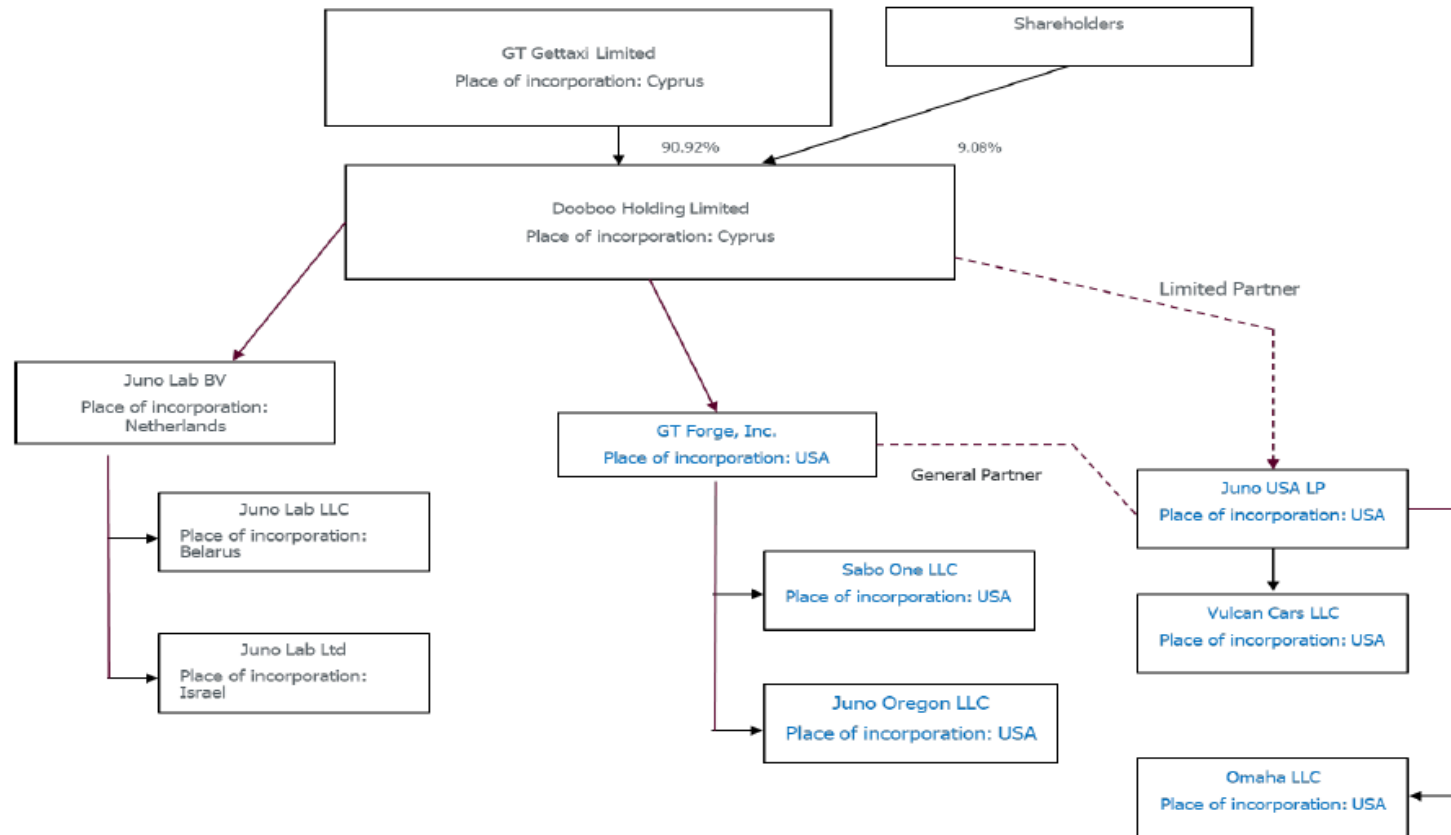
- Use of bankruptcy as a collective means to identify and resolve litigation and other claims
  - Litigation proceeds often the primary source of recovery given heavily levered capital structures
  - Affiliated party may act as plan sponsor or DIP lender
- Use of bankruptcy to restructure debts and obligations within a corporate group
- “Global settlements” that may be vetted and negotiated pre-petition by independent directors, then again post-petition by unsecured creditors committees and/or examiners
  - Avoid cost, delay and uncertainty of litigation

# Factors Driving The Business Need for Third Party Releases (Cont.)

- Situations may include (but are not limited to):
  - Subsidiary debtor and non-debtor parent/affiliates
    - ❖ All named defendants in litigation
    - ❖ Debtor defendant with single-entity theories of liability against the non-debtor parent/affiliates
    - ❖ Parent subject to breach of fiduciary duty claims
    - ❖ Non-debtor parent/affiliates subject to claims by the debtor/creditors due to transactions with the debtor that give rise to avoidance actions, breach of contract claims, etc.
  - Debtor parent and non-debtor subsidiaries
    - ❖ Restructure debt to eliminate upstream guarantees by non-debtor subsidiaries

# Juno USA, LP, et al. – Chapter 11

Organization Chart (Debtors in Blue)



# Juno USA, LP, et al. – Chapter 11 (Cont.)

- Petition Date – November 19, 2019
- Filed in Delaware (Judge Walrath)
- Third largest ride-hailing business in New York (after Uber and Lyft)
- Foreign parent and non-Debtor affiliates
- Due to new local regulations, compounded by an increasing number of litigation claimants, the Company determined it was in the best interests of all stakeholders to shut down US “business-to-consumer” (“B2C”) operations
- Reorganized debtor GT Forge to develop strategic partnerships with certain competitors in the ride-hailing space, with intention to emerge as a leading global “business-to-business” (“B2B”) transportation network company
- Confirmation Date – March 25, 2020

# Juno USA, LP, et al. – Chapter 11 (Cont.)

- Capital Structure
  - Operations funded pre-petition on an unsecured basis from non-debtor parent, GT Gettaxi Limited
  - USD \$171M Sberbank term loan
    - ❖ Borrower is GT Gettaxi Limited
    - ❖ Guarantors are Juno USA and GT Forge
  - Sberbank held perfected, first-priority all asset lien against GT Forge, including its partnership interest in Juno USA
  - Post-petition, GT Gettaxi Limited also became DIP Lender

# Juno USA, LP, et al. – Chapter 11 (Cont.)

- Key Plan Terms:
  - GT Gettaxi Limited (non-debtor parent)
    - ❖ Receives:
      - Release (opt-out) from litigation by the drivers, as well as patent infringement, personal injury and other litigation/claims
      - Equity of reorganized debtor (GT Forge), including net operating losses exceeding \$90M
    - ❖ In Exchange For:
      - \$875K plan contribution, estimated to provide a return to unsecured creditors of 15-25%
      - Repayment of the ~\$1.6M DIP facility
      - Cancellation of intercompany debt exceeding \$100M

# Consent

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# Establishing Consent

- Court decisions determining the range of nonconsensual third party releases “occupies the spectrum between ‘impossible’ and ‘very rare.’” *In re FirstEnergy Solutions Corp.*, 18-50757 (Bankr. N.D. Ohio Aug. 29, 2019)
- Parties pursuing a chapter 11 plan containing third party releases in ‘impossible’ jurisdictions (5<sup>th</sup>, 9<sup>th</sup> and 10<sup>th</sup> Circuits), or fail to meet the rigorous standards in the ‘very rare’ jurisdictions (2<sup>nd</sup>, 3<sup>rd</sup> 4<sup>th</sup>, 6<sup>th</sup>, 7<sup>th</sup>, 11<sup>th</sup> and lower court decisions in 1<sup>st</sup> and 8<sup>th</sup> Circuits) may structure the plan solicitation to argue the parties gave consent, or their consent was deemed given

# Consent?

**Affirmative  
Consent**

**Deemed or Implied  
Consent for Voting  
Parties**

**Unimpaired or  
Deemed Rejected Non-  
voting Parties**

# Determining Consent

- No standard or rule to determine consent under the Bankruptcy Code
- Courts generally apply common law contract principles in determining whether a creditor consented to a third party release
- Consent may be express or manifested by conduct. Restatement (Second) of Contracts § 19 (1981)
- Due process concerns often not expressly discussed in decisions

# Determining Consent (Cont.)

- Restatement (Second) of Contracts § 19 (1981):
  - The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act
  - The conduct of a party is not effective as a manifestation of his assent unless he intends to engage in the conduct and knows or has reason to know that the other party may infer from his conduct that he assents
  - The conduct of a party may manifest assent even though he does not in fact assent. In such cases a resulting contract may be voidable because of fraud, duress, mistake, or other invalidating cause

# Affirmative Consent

- Courts generally agree that an affirmative vote to accept a plan that contains a third-party release constitutes an express consent to third party releases in the plan
- **Opt-in** to a release on the ballot also evidences intent to consent to the third party release
  - *See In re Chassix Holdings, Inc.*, 533 B.R. 64 (Bankr. S.D.N.Y. 2015). The bankruptcy court modified the scope of “consenting creditors” to only those that voted in favor of the plan, or those that rejected the plan yet still affirmatively elected to provide releases
  - *In re Specialty Equip. Companies, Inc.*, 3 F.3d 1043, 1047 (7th Cir. 1993) (“a consensual release does not inevitably bind individual creditors. It binds only those creditors voting in favor of the plan of reorganization.”)

# Implied Consent

- “Deemed consent” raises a more difficult question. “Absent a duty to speak, silence does not constitute consent.” *In re SunEdison*, 576 B.R. 453, (S.D.N.Y. Nov. 8, 2017)
- Deemed consent cases generally involve:
  - creditors that do not vote, or creditors that vote but do not check the opt-out box (i.e., inaction)
  - unimpaired creditors (i.e., deemed to consent because lack of debtor claim impairment)
  - plans with conspicuous warnings (i.e, consent through silence)

# “Opt-out”

- **Opt-out + Rejecting Plan:**

- *In re Chassix* the court determined this was an impermissible trap for the inattentive creditor. The bankruptcy court modified the scope of “consenting creditors” to only those that voted in favor of the plan, or those that rejected the plan yet still affirmatively elected to provide releases

- **Opt-out ballot not returned + Approving Plan:**

- *In re Washington Mutual* held that the Plan must include a proper opt-out mechanism. Plan was insufficient to support the third party releases, particularly with respect to parties that did not return a ballot or were not entitled to vote. “Any third party release is effective only with respect to those who affirmatively consent to it by voting in favor of the Plan and not opting out of the third party release”

- **Opt-out ballot not returned:**

- *In re Indianapolis Downs, LLC* determined consent manifested if a creditor does not affirmatively opt-out (or for those who deemed to reject the plan). Knowing failure to opt out held as consent

# Unimpaired Creditors

- Case law varies whether unimpaired creditors that do not vote on the plan should be deemed to consent to third party releases
- Courts holding that unimpaired creditors must opt-in to a third party release reason that the release of claims against third parties make the claim “impaired” for voting purposes and must manifest consent by an opt-in
- **However**, Judge Silverstein in *In re Millennium Lab Holdings II, LLC*, found it **permissible** to impose third-party releases on unimpaired creditors, reasoning that Bankruptcy Code section 1124(1) applies impairment only to claims against the debtor and not to claims against third parties that may be liable to the unimpaired creditors

# Unimpaired Creditors (Cont.)

- *Compare cases saying inaction is not sufficient to show consent:*
  - *In re Southeast Grocers, LLC*, No. 18-10700 (MFW) (Bankr. D. Del. May 14, 2018), ECF No. 487 (holding that all creditors, including those unimpaired and deemed to accept, must consent to the release to be bound)
  - *In re Washington Mut. Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011) (holding that “inaction” was not a sufficient manifestation of consent to support a release)

# Unimpaired Creditors (Cont.)

- *To cases holding inaction may manifest consent:*
  - *In re Indianapolis Downs*, 486 B.R. 286 (holding that failure to opt out regardless of impairment or deemed acceptance status results in being bound)
  - *In re Spansion, Inc.*, 426 B.R. at 144 (finding that a release was not overreaching to the extent it bound unimpaired classes deemed to accept the plan since those creditors were being paid in full and had received adequate consideration of the release)
  - *In re Genco Shipping & Trading Ltd*, 513 B.R. 233 (Bankr. S.D. N.Y. 2014). Judge Lane overruled the U.S. Trustee's objection, finding that a plan can require unimpaired claimholders to grant a release to nondebtors even when such parties were not entitled to vote on the plan and did not otherwise consent to, or have an opportunity to opt out of, granting such a release

# Silence as Consent

- In *SunEdison*, the court recognized only three limited exceptions to establishing silence as consent:
  - It is supported by the parties' ongoing course of conduct (Restatement § 691(1));
  - The offeree accepts the benefits of the offer despite a reasonable opportunity to reject them, and understands that the offeror expects compensation; or
  - The offeror has given the offeree reason to understand that silence will constitute acceptance and the offeree in remaining silent intends to accept the offer.
- In *SunEdison*, insufficient facts supporting the creditors deemed to consent to the broad releases. The warnings and conspicuous language in the disclosure statement was not sufficient to give rise to a duty to speak, and the lack of an objection should not be deemed consent

# Silence as Consent (Cont.)

- *Silence does not manifest consent:*
  - *In re Chassix Holdings, Inc.*, 533 B.R. 64, 81 (Bankr. S.D.N.Y. 2015)
  - *In re Wash. Mut., Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011))
  - *In re Westinghouse Electric Co.*, Case No. 17-10751 (Bankr. S.D.N.Y. March 29, 2017)
- *Silence may manifest consent:*
  - *In re Cumulus Media Inc.*, Case No. 17-13381 (Bankr. S.D.N.Y. Nov. 29, 2017)
  - *In re Indianapolis Downs LLC*, 486 B.R. 286 (Bankr. D. Del. 2013)
  - *In re TK Holdings, Inc.*, Case No. 17-11375 (Bank. D. Del. June 25, 2017)

# Cross Border Issues

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# I. A Tale of Two Cases

- In re Vitro S.A.B. de C.V., 70 F.3d 1031 (5<sup>th</sup> Cir. 2012), cert den., 133 S.Ct. 1862 (2013)
- In re Avanti Communications, 582 B.R. 603 (Bankr. S.D.N.Y. 2018)

## II. Some Other Chapter 15 Decisions Recognizing Third Party Foreign Releases

- In re **Metcalfe & Mansfield Alternative Investments**, 421 B.R. 685 (Bankr. S.D.N.Y. 2010) (Canadian plan).
- In re **Sino-Forest Corp.**, 501 B.R. 655 (Bankr. S.D.N.Y. 2013) (Canadian plan)
- In re **Emeco Holdings Ltd.**, 16-13080 ( Bankr. S.D.N.Y. 2016) (Australian Scheme)
- See list of other cases cited by the court in **Avanti** at p. 616.

# III. Some Countries Are More Receptive to Third Party Releases Than Others

- Generally receptive—Canada, Mexico, UK, Australia, Singapore
- Generally not receptive—France, Germany, Italy

# IV. What is the Best Strategy in a Cross-Border Case Where Debtor Wants Third Party Releases But Anticipates U.S. Holdouts?

- Confirm a plan in a foreign proceeding and seek recognition in an ancillary Chapter 15 case in the U.S. or
- Confirm a plan in a U.S. proceeding
- Keep in mind the limitations set forth in In re **Barnet**, 737 F. 3d 238 (2 Cir. 2013) (requiring the debtor to be eligible to file a Chapter 15 by having a domicile, place of business or assets in the U.S.) and the influence, if any, of the UNCITRAL Model Law on Recognition and Enforcement of Bankruptcy-Related Judgments (2018), which, to date, has not yet been adopted in any jurisdiction but have some persuasive effect.